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Export Subsidies of the Caribbean Basin and a Proposed Revision of International Rules Regarding Countervailing Duties

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EXPORT SUBSIDIES OF THE CARIBBEAN BASIN AND A PROPOSED REVISION OF INTERNATIONAL RULES REGARDING COUNTERVAILING DUTIES

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The countries of the Caribbean Basin, in common with other LDCs, face the constant threat of countervailing duties being imposed on a variety of their exports to the United States. The possibility of revising the internal rules of the game in the area of countervailing duties has been advised by a number of interested parties and is presently being considered at the Multilateral Trade Negotiations (MTN) in Geneva. The developing countries have been trying, with considerable resistance from some of the developed countries, to obtain special rules which would apply to them in this area. In order to understand the problems that the LDCs face and the viability of proposals for differential treatment, it is necessary to consider the context in which all of the issues are being considered. This paper will first examine the fundamental issues under discussion, then the problems which arise for Caribbean Basin countries,

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and finally, possible rules to resolve the conflict for developing countries of the Basin.

BACKGROUND AND ISSUES

Countervailing duties are special duties imposed on imports in addition to the normal tariff, which are designed to offset in value export subsidies which are granted by a foreign country. Such duties are imposed under the justification of either protecting the integrity of international comparative advantage in trade or the tariff structure of the importing country. In order to insure uniform rules in the area of countervailing duties, article VI was incorporated in the GATT,[1] but as time passed, both the United States and its principal trading partners became dissatisfied with distinct aspects of the provisions. The United States became disgruntled with the provision which excluded rebates of consumption or so-called "indirect taxes" on exports from the definition of an illegal bounty or subsidy while including income and profit-type "direct tax" rebates. At the time this paper was drafted, it was the prevailing wisdom of economists that direct taxes such as income and profit taxes were not included in the price of products, whereas indirect taxes such as sales taxes, excise taxes and value-added taxes were shifted forward. Thus, it was reasoned that a rebate of indirect taxes did not benefit exports. Over time, the validity of the distinction was increasingly questioned, but the rule did not change. Since the Europeans had come to rely more heavily upon indirect taxes in their tax structures than the United States, the Americans felt that they were put at an unfair disadvantage.

On the other side, the Europeans faced a disadvantage vis-à-vis the United States under the injury requirement of the GATT. Under article VI, countervailing duties were to be imposed only if subsidized imports caused material injury to the domestic industry of like products of the importing country. When the GATT was implemented, however, a grandfather clause was agreed to which allowed signatory countries to maintain inconsistent national legislation which pre-dated the GATT.[2] The United States had a prior countervailing duty law without an injury requirement and it chose to invoke the grandfather clause and apply countervailing duties without a show of injury to U.S. industry.

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1. The General Agreement on Tariffs and Trade, Oct. 30, 1947, 55 U.N.T.S. 194, T.I.A.S. No. 1700 (1948).
2. Protocol of Provisional Application of The General Agreement on Tariffs and Trade, 55 U.N.T.S. 308.

While this situation left both sides somewhat dissatisfied, there was no serious move to reconcile the conflict until 1977, when a U.S. customs court reversed a long-standing administrative practice of the U.S. Treasury Department. The court in *Zenith Radio Corp. v. United States*[3] ruled that certain Japanese consumption tax rebates were illegal bounties and grants within the meaning of the countervailing duty law of the United States. The case prompted a charge of foul play by developed trading partners of the United States which saw the decision as upsetting the former balance, and serious discussions began at the MTN regarding the possibility of a modification of the international rules.

CARIBBEAN BASIN PRACTICES

The *Zenith* decision and aftermath have created a most propitious opportunity for the developing countries to undertake changes in the rules. The developing countries, including a number of those from the Caribbean Basin, have faced a problem which is of a nature different from that of the developed countries. A number of them undertook domestic programs to substitute local production for imports in order to solve balance of payments problems and accelerate economic development. The policy provoked situations in which high import barriers were imposed to protect the new producers, and financial exchange rates became increasingly lower than those which would have prevailed in a free trade environment. The result was to distort the true comparative advantage of developing countries to the disadvantage of their exports.[4] Gradually, some of the countries came to recognize that import-substitution policies had gotten out of hand and in many cases were exacerbating rather than solving balance of payments problems. The response to this was a distinct shift in the mid-sixties and early seventies to export promotion strategies which were designed to stimulate new exports of nontraditional, generally semimanufactured articles principally to developed country markets. This change of policy could have been best accomplished through devaluation and an overall reduction of import duties which would have decreased input costs of exports and increased the profitability of exporting relative to other activities. Local

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3. Zenith Radio Corp. v. United States, 430 F. Supp. 242 (Cust. Ct. 1977).

4. *See, e.g.,* D. Schydlowsky, The Subsidy and Countervailing Duties Negotiations and the Developing Countries, Paper presented at the Seminar on the Multilateral Trade Negotiations and the Developing Countries of the Agency for International Development and Foreign Service Institute, February 22, 1977, and Perez, *Export Subsidies in Developing Countries and the GATT,* 10 J.W.T.L. 529 (1976).

producers created by the import-substitution policy, however, were often sufficiently entrenched to prevent such change which would have opened them to import competition and would have drawn investment away from them to export activities. Consequently, the countries frequently adopted less efficient mechanisms in the form of export subsidies, often on an ad hoc basis, in favor of specific products.

The types of subsidies one finds are remarkably similar among developing countries and generally illegal under GATT and U.S. countervailing duty rules. A sample of the more common subsidy practices, all of which have been or are currently being used in some of the Caribbean Basin countries, would include:

1. Custom duty exemptions on imports of machinery and equipment used for the production of exports;
2. Cash rebates or certificates whose face value is a percentage of the domestic value added or export price of a product, or, is a percentage of increased profits from exports compared to the prior year, which certificates are freely negotiable and accepted by the government to satisfy income and profits tax liabilities;
3. Government-supported loans for export production and export financing at below-market interest rates;
4. Government assistance in export credit insurance costs;
5. Special depreciation allowances related to export performance; and
6. More favorable exchange rates for export transactions.

While the above practices are not always the most efficient mechanisms and can create some of the same problems that excessive import-substitution had experienced, the governments have felt assured of adopting the best measures possible to achieve their goal of export expansion, given the political constraints they face. When countervailing duties were applied to such subsidized exports, the developing countries somewhat justifiably complained that such subsidies merely correct distortions to comparative advantage rather than create them.

The situation was ameliorated, in certain respects, by the fact that such arguments were sometimes unofficially recognized by administrators of countervailing duty codes in a number of cases and enforcement was not always strict.

THE STAGE FOR REFORM

The world recession of the 1970s and the 1974 Trade Act of the United States, induced a number of changes. Prior to the Trade Act, the U.S. customs courts had given the U.S. Treasury Department, which administers the countervailing duty law, a fair amount of discretion in interpreting and applying countervailing duties. The appellate customs court, for example, turned back a challenge by a U.S. manufacturer to a. Treasury Department negative determination of countervailing duties, ruling that such manufacturers were not empowered to compel judicial review by customs courts in such cases.[5] This broad discretion was subsequently limited, however, by both judicial decision[6] and the Trade Act of 1974[7] which allowed judicial challenge by U.S. manufacturers of such negative determinations. With the world recession increasing protectionist pressures and with the modification of the countervailing duty code by the Trade Act, the countervailing duty law became a more useful instrument against developing countries, and the *Zenith* case set the stage for reform.

Several factors, however, worked against the broad reform that was needed. First, the rules of international trade have historically been made by the developed countries to facilitate trade among themselves. Secondly, a genuine reform of the rules is least likely in a protectionist environment, especially a reform which would give preferential rules in favor of some countries. Thus, the *Zenith* case created somewhat of a rare opportunity because it suddenly appeared to throw out the established norms for trade among the developed nations and raised the possibility of U.S. protectionists using countervailing duties as an instrument against a wide variety of trade goods of the developed countries. Reform of the rules of the game now seemed the most prudent of all the alternatives and it raised the possibility that the developed countries might be able to get in some special rules to take into account their special circumstances.

A good part of the drama and suspense of the situation, as well as a part of the momentum for reform, was lost when the appellate customs court overturned the lower court decion in *Zenith*.[8] The drive for reform has not died, however, and revision is still possible, and discussions regarding reform still proceed at Geneva. Given the increased availability of countervailing duties in the United States as a protectionist instrument and the widespread use of export subsidies by developing countries, it still

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5. United States v. Hammond Lead Products, Inc., 440 F.2d 1024 (C.C.P.A. 1971), *cert. denied*, 404 U.S. 1005 (C.C.P.A. 1971).

6. National Milk Producers Federation v. Schultz, 372 F. Supp. 745 (D.D.C. 1974).

7. Trade Act of 1974, 19 U.S.C. §§ 1301 *et. seq.*

8. United States v. Zenith Radio Corp., 562 F.2d 1203 (C.C.P.A. 1977). On appeal the Supreme Court affirmed the CCPA thus denying Zenith's request that countervailing duties be imposed and confirming the propriety of Treasury's traditional practice, ____ U.S. ____, 98 S. Ct. 2441 (1978).

remains an important issue. The success of the developing countries in getting special rules for application to their subsidized exports will depend upon several things. They will need to ensure that differential rules are formulated which will, in fact, confer a true benefit in their favor. They have learned that the differential treatment they have received under the GSP has been so circumscribed by special rules that the benefits have been more modest than they had hoped.[9] At the same time, however, their proposals will have to be sufficiently realistic so as to be politically palatable to the developed countries.

One proposal which has been discussed and which seeks to strike a balance between both of these somewhat conflicting necessities is that of differential injury requirements for developing and developed countries' subsidized exports. The specifics of a proposal of this type can be suggested by borrowing from GATT, and various U.S. statutes and administrative practices in the area of trade. Basically, traditional escape clause requirements could be applied by developed countries to imports of subsidized goods from developing countries while applying traditional countervailing duty norms to subsidized goods from other developed countries. The issue of direct versus indirect tax exemptions would be irrelevant in the case of LDCs since the issue would be whether the domestic industry of the developed country suffered the requisite injury from subsidized imports from an LDC, irrespective of the form of the subsidy.

Injury Requirement[10]

Under an escape clause-type rule, it could be required that subsidized imports from LDCs be imported in such increased quantities as to cause "serious injury" to the domestic industry of the developed country before applying countervailing duties, whereas the test for subsidized imports from other developed countries would be the present GATT rule, requiring that illegally subsidized imports cause "material injury" to the competitive domestic industry.

Causation Requirement

In addition to the above element, it would be necessary to show that the subsidized imports were the "major cause" of the serious injury, *viz.*,

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9. *See* R. Baldwin, & T. Murray, *MTN Tariff Reductions and Developing Country Trade Benefits Under the GSP* (mimeo.) (1976).

10. Under U.S. trade legislation, injury determinations are generally made by the International Trade Commission. *See* Anti-Dumping Act, 1921, 19 U.S.C. § 160, and Trade Act of 1974 § 331(a).

the causation of injury by the disputed imports have to be a cause greater than all other causes combined.[11] The GATT norm for application to developed countries would continue to be that the imports be the "principal cause" of injury, implying only that it be more important than any one other of a variety of possible causes. Judging from past U.S. application of these criteria, the causation element would probably produce more differential treatment than any other element.

An added requirement could be borrowed from antidumping rules and included as part of a causation requirement. In some U.S. antidumping cases, the ITC has ruled that it could be presumed that no causation existed because the offending imports did not represent a sufficiently large portion of U.S. consumption.[12] This interpretation could be formalized by allowing an LDC or group of LDCs to subsidize a product to a developed country without fear of countervailing duties until such product reached a certain proportion, such as ten percent, of total consumption of the good in the developed country. This would limit the use of countervailing duties as a protectionist instrument and allow those LDCs which are relatively new and weak in the market an advantage over other LDCs which have become rather proficient in marketing the same product, and which hardly qualify as "less developed" for that good.

This rule does, in fact, have the double advantage of distinguishing between relatively less and more moderately advanced developing countries. This is an issue which has caused considerable problems with the whole concept of differential treatment for developing countries. The more advanced of them have pressured for differential treatment which is uniformly applied to all developing countries while the developed countries have felt that some of the larger, more advanced LDCs have become competitive in a number of products of a medium level of technology and do not need special and differential advantages. Thus, the developed countries have been more resistant to differential treatment than they would have otherwise. The ten percent rule would provide a partial compromise to this problem.

The integrity of the ten percent rule could be preserved only through the adaptation of a related rule which is used in conjunction with it.

11. This norm was used in the escape clause of the United States prior to the modifications contained in the Trade Act of 1974 § 201. *See, e.g.*, Trade Expansion Act of 1962, 19 U.S.C. § 1901.

12. ITC, Pub. No. 764, *Butadiene Acrylonitrile Rubber from Japan* (1976); U.S. Tariff Commission, Pub. No. 476 *Large Power Transformers from France, Italy, Japan, Switzerland, and United Kingdom* (1972); U.S. Tariff Commission, Pub. No. 332 *Whole Dried Eggs from Holland* (1970); and U.S. Tariff Commission, Pub. No. 265 *Pig Iron from East Germany, Czechoslovakia, Romania, and the U.S.S.R.* (1968).

When determining whether the disputed imports are sufficiently large to cause the requisite injury, the ITC will occasionally accumulate the individual shares of offending imports of several countries so that their aggregate market share is sufficiently large to establish causation.[13] This practice could be modified in the case of developing countries to provide that the aggregation of developing countries together would not be permissible in establishing causation. Thus, combining this rule with the market share requirement, countervailing duties would be applicable to only developing countries which reached the ten percent of the U.S. market requirement, and where a developing country is aggregated with a developed country, duties would be applicable against only the developed country.

Definition of Domestic Industry

A last element that could create differential treatment is that of the definition of the domestic industry which is injured. One practice has been to allow the definition of the domestic industry to be limited to a regional area under certain circumstances which has the effect of making it easier to find that "the domestic market" (or "a" domestic market) has been injured.[14] This definition is applied where the regional market is isolated from the rest of the national market because of transportation costs, traditional patterns of distribution or consumer tastes, and where all the sellers and producers within the regional market sell almost all of their production in that market, or almost none of the product produced elsewhere in the country is sold in that regional market. This rule could be modified in the case of LDCs to require that the segmented, regional market represent at least twenty-five percent of the market of the developed country for that good before the special definition could be applied.

How would the above rules affect the Caribbean Basin countries? The impact would vary a great deal from country to country. For those countries which are significantly involved in export promotion, the rules would be enormously helpful. Within the recent past, several Basin countries have been pressured into agreeing to the gradual withdrawal of a number of subsidies granted to goods sent to the United States. A rule

13. *Pig Iron from East Germany, supra* note 12; ITC, Pub. No. 639 *Primary Lead Metal from Australia and Canada* (1974) at 12-13, 22-24.

14. *See, e.g., Steel Bars, Reinforcing Bars, and Shapes from Australia,* 35 *Fed. Reg.* 4,161 (Tariff Comm'n 1970). In this case, the regional market in question represented only one-half of one percent of U.S. consumption, yet the opinion of the Commission stated, "In weighing the injury, we have applied the principle that an injury to a part of the national market is an injury to the whole market."

requiring a showing that such subsidized imports were the major cause of serious injury would have put them at a significantly stronger negotiating position relative to the current situation. Of course, a number of Basin countries, particularly the smaller islands, are still principally exporters of traditional agricultural goods such as sugar and have little manufacturing activities from which to encourage exportation, thus the rules would mean little to them in the near future.

These rules, which no doubt would fail to satisfy everyone, offer several advantages. First, more "pure" economic formulations which would seek to calculate the amount of the distortion are not administratively practical. There is no sufficient agreement among economists as to the proper manner in which to calculate the social costs which would be required, and the data requirements for such calculations make them somewhat impractical to administer on a product-by-product/country-by-country basis. Second, an examination of the application of different injury standards in U.S. trade legislation would, at least, indicate that a fair amount of differential treatment would be created in favor of LDCs by these norms.[15] Third, the rules are cast within the framework of traditional trade practices of the developed countries which should permit a reasonable evaluation of their potential impact through the developed countries' attempt to appraise their political acceptability. Finally, for developing countries, the rules avoid the very difficult problem of defining an acceptable versus an unacceptable subsidy practice.

These rules also face some obstacles. First, the trend in the United States trade field has been to lessen rather than strengthen the injury requirement. In the area of antidumping rules, the standard has gradually shifted from showing the equivalent of "material injury" to "de minimis" injury in addition to a causation requirement of only "de minimis."[16] Likewise, the standard for injury under the U.S. escape clause has been reduced by the 1974 Trade Act. In addition, it now appears that the United States intends to follow the extremely weak "de minimis" test in making countervailing duty determinations of duty-free imports as

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15. *See, e.g.*, an analysis of their application in, ORGANIZATION OF AMERICAN STATES, *GATT Rules and U.S. Law Regarding Export Subsidies and Countervailing Duties*, OEA/Ser. H/XIII CIES/CECON-COMERCIO/142 (1977).

16. *Compare*, U.S. Tariff Commission, Pub. No. 109 *Cylinder, Crown, and Sheet Glass* (1963), and U.S. Tariff Commission, Pub. No. 214 *Cast Iron Soil From Poland* (1967).

required under the Trade Act of 1974.[17] Second, the developed countries appear to be backing off significantly from any talk of differential treatment for developing countries in the current round of trade negotiations in Geneva. This is particularly unfortunate in this area since the LDCs have a rather compelling argument for differential treatment in the area of countervailing duties.

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17. ITC, Pub. No. 787 *Certain Zoris From the Republic of China (Taiwan)* (1976). In consideration of the 1974 Trade Act, the House Ways and Means Committee Report clearly stated that it was the intention of the Committee that the injury requirement for countervailing duties on duty-free imports should be the equivalent of that applied to antidumping duties where a "de minimis" standard was in use. The comments of the Senate Finance Committee, however, can be construed to mean that they expected it to be interpreted so as to be consistent with the GATT requirement of "material injury." *Compare:* HOUSE COMM. ON WAYS AND MEANS, TRADE REFORM ACT OF 1973, H.R. Rep. No. 93-571, 93d Cong., 1st Sess. 74 (1973), and SEN. COMM. ON FINANCE, TRADE REFORM ACT OF 1974, S. Rep. No. 93-1298, 93d Cong., 2d Sess. 185 (1974).